STOCKS DOWN UNDER

14 SEP 2022

ASX Property Stocks Down Under

No legacy is so rich as honesty.

- William Shakespeare (1564-1616), Playright, poet & actor

SCENTRE GROUP

Frank Lowy's legacy continued

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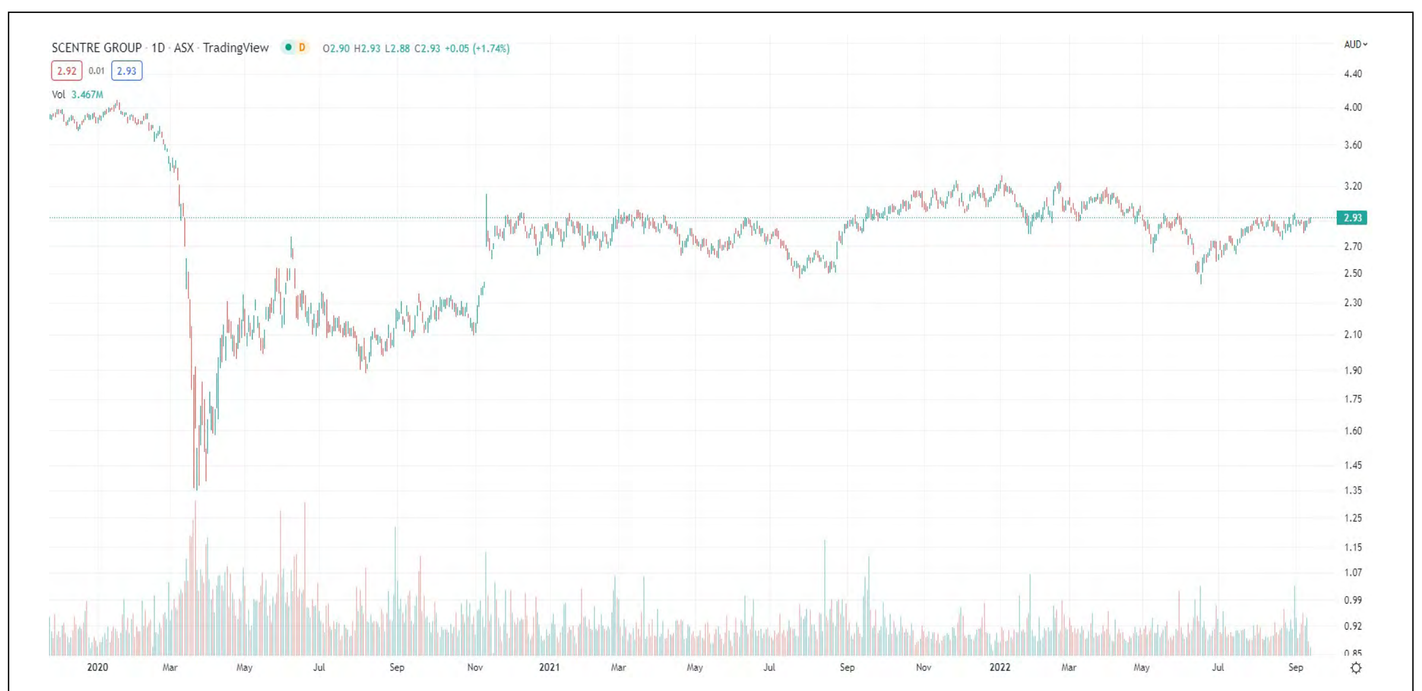
Stocks Down Under rating: ★★★★

ASX: SCG
Market cap: A$15.2BN

52-week range: A$2.42 / A$3.30
Share price: A$2.92

Frank Lowy may have retired, but the Westfield empire he created still lives on. Scentre Group (ASX: SCG) owns 42 Westfield shopping centers in Australia and New Zealand that attract over 500m visitors annually. Shares were badly beaten by the Corona Crash and have never totally recovered, but have been gradually on the way up ever since. Can it complete the recovery soon?

Share price chart



Source: Tradingview

Still on a road to recovery, and its getting bumpy again

This is the third time we have covered Scentre Group, the two previous occasions were in July 2020 and June 2021. As we outlined in those editions, retail centers were hit by the pandemic with many outlets being forced to close and consumers taking their time to come back when the stores re-opened.

But even though Scentre claims visitors have returned, its property valuations have grown and its share price is up 4% in 12 months (whereas the ASX 200 REIT Index is down over 12% in as many months); this company is trading at an NTA discount of roughly a third. Why? One might argue it is rising inflation and interest rates – with fears by investors that consumers will spend less and it would flow-on to Westfield tenants, forcing them to vacate. In addition, REITs on the ASX such as Scentre would face higher debt costs. The former scenario hasn't happened...yet. Occupancy rates remain high (at 98.8%) and sales at Scentre's tenants remain strong and are growing. And remember, Scentre has about 80% of its leases with clauses that lift rents by inflation plus 2%. The latter has not yet shown in its results, but that possibility remains.

Perhaps also playing a part is that long-serving boss Peter Allen is standing down on 1 October, to be succeeded by current CFO Elliott Rusanow. Time will tell how the latter goes, but investors never like it when long term CEOs depart – no matter what the reason. And arguably, investors fear that eCommerce will replace physical malls for good. Some of Scentre's responses, such as the Westfield Direct platform offering click and collect services, may give weight to that inference. But we think visitor numbers show that even though the pandemic has caused growth in eCommerce, this has not been at the expense of physical retailers.

Results are improving

In FY21 (the 12 months to 31 December 2021), the company returned to profitability. Having dropped to a $3.7bn loss in FY20 (inclusive of unrealised movements), it returned to an $887.9m profit and paid a distribution of 14.25c (representing a 4.5% yield at the $3.16 share price on the day of its result). It held $50.4bn in Assets Under Management and recorded Funds From Operations (FFO) of $862.5m, or 16.6c per security.

Obviously, the catalysts were people returning to malls and new leasing deals (with existing and new customers). It boasted available liquidity of $5.6bn, enough to cover all debt maturities to early 2024, had gearing of just 27.5% and an interest cover of 4x.

On the ESG front, it had cut emissions by 30% since 2014, was on track to achieve at least 50% of its Net Zero by 2025 and had accelerated its reliance on renewable energy. It forecasted further growth for FY22, but the only formal guidance it gave was for a distribution of 15c per security.

In 1HY22, it depicted it was on track to deliver an even better year in FY22 than in FY21. It recorded an operating profit of $540.5m (up 18% from 1HY21), FFO of $548.6m (or 10.58c per security) and it paid a distribution of 7.5c per security. Its liquidity had grown to $4.8bn, sufficient to cover debt maturities up to Q4 CY25. With an NTA of $4.32, it is trading at a roughly 30% discount. Assuming it delivers the same FFO in 2HY22 (equating to 21.16c per security), it is trading at a P/FFO multiple of 13.5x. And at the current share price, it yields 5.2%.

Why we like Scentre

We admit that compared to Vicinity, there is less of a ‘recovery’ thematic still present in the company because Vicinity relies more heavily on international tourists. Scentre Group’s fate may well be tied to the rest of the ASX REIT sector, which may be in the doldrums until the interest rate hiking cycle is over. It has got $4.5bn of future developments in its pipeline, which are at the mercy of supply chain issues for the foreseeable future. And it’s yield falls somewhat short of being ahead of inflation. But Scentre has enough in its favour to win it four stars from us.

First, its solid outlook and relatively cheap multiples. Second, its increasing digitisation initiatives, such as Westfield Direct and Westfield Plus. The latter is a membership program that boasts 2.75m members, a figure that’s grown by 550,000 in 1HY22 alone. Third, notwithstanding potential construction issues, we like how Scentre is reinvesting in its existing assets rather than going out buying new ones. It is targeting a yield of 6-7% with an incremental IRR of 12-15%. These initiatives will in the long run encourage people to return more often for longer and will increase the rents they can derive from them. And fourth, its lower gearing and high credit ratings, which indicate that it will be in a position to handle interest rate hikes for some time yet.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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